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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 57

FEDERAL POWER COMMISSION, PETITIONER,

v.

LO-VACA GATHERING COMPANY, HOUSTON PIPE LINE COMPANY, AND EL PASO NATURAL GAS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR FEDERAL POWER COMMISSION

OPINIONS BELOW

The opinions of the Court of Appeals for the Fifth Circuit (R. 365-376) are reported at 323 F.2d 190. The opinions and orders of the Federal Power Commission (R. 256-277, 332-334) are reported at 26 FPC 606 and 840.

JURISDICTION

The judgment of the Court of Appeals setting aside the Commission's order was entered on September 24, 1963 (R. 377). A timely petition for rehearing was

denied on December 17, 1963 (R. 379). On March 10, 1964, Mr. Justice Black extended the time for filing a petition for a writ of certiorari to April 15, 1964 (R. 380). The petition was filed on April 10, 1964, and certiorari was granted on June 1, 1964 (R. 381). The jurisdiction of this Court rests on 28 U.S.C. 1254 (1) and Section 19 (b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

When a supplier sells natural gas to an interstate pipeline company, which commingles it with gas from other sources and uses some of the mixture for local sales or in the operation of the pipeline, but sells the bulk in interstate commerce, may the supplier and pipeline avoid the jurisdiction of the Federal Power Commission over "sales in interstate commerce for resale" by stipulating, contrary to the physical fact, that all of the supplier's gas will be consumed within the State or by the pipeline?

STATUTE INVOLVED

The Natural Gas Act, 52 Stat. 821, as amended, 15 U.S.C. 717-717w, provides in pertinent part:

> Section 1 (b). The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural

gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 2. When used in this act, unless the context otherwise requires—

* * * * *

(7) "Interstate commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.

STATEMENT

This case involves the jurisdictional status, under Section 1 (b) of the Natural Gas Act, of sales which Lo-Vaca Gathering Company and Houston Pipe Line Company propose to make to El Paso Natural Gas Company.

El Paso, one of the country's largest interstate natural gas pipelines, obtains its gas supplies chiefly in the Panhandle and Permian Basin areas of western Texas and the San Juan Basin in northwestern New Mexico. Its main transmission lines extend in two parallel systems from western Texas, across New Mexico and Arizona, to the California border. While it has many customers along the route, the bulk of its deliveries are made at the Arizona-California border to three California distribution compañies, including

two of the intervenors below, Southern Counties Gas Company and Southern California Gas Company.[1]

The Lo-Vaca contract. On March 15, 1960, El Paso entered into a contract with Lo-Vaca Gathering Company for the purchase of gas in the Texas Gulf area, to be delivered for El Paso's account to El Paso Gas Supply Company, a wholly owned subsidiary, at a point in the immediate vicinity of Three Rivers, in Live Oak County, Texas (R. 256-257).[2] Gas Supply was to construct a compressor station at Three Rivers (the Coquat Station) and a 227-mile pipeline from Three Rivers to one of the southernmost points of the present El Paso system, the Sonora plant in Sutton County, Texas (R. 256-257).[3] The contract provides for the delivery to El Paso of 50,000 Mcf of gas per day at an initial price of 22¢ per Mcf, with escalations

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[1] This description is based upon the statement of facts in *People of the State of California* v. *Federal Power Commission*, 296 F.2d 348 (C.A.D.C.), reversed, 369 U.S. 482. It describes the El Paso system prior to the merger with Pacific Northwest Pipeline Corporation. Commission authorization of that merger was set aside by this Court in the cited case and divestiture was ordered in *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651.

The State of California and the two companies named in the text are the petitioners in Nos. 46 and 47, this Term.

[2] Another El Paso-Lo-Vaca contract, dated May 16, 1960, is admittedly a sale in interstate commerce for resale, and is not involved in this proceeding. Lo-Vaca is not itself a producer of natural gas, but will purchase the gas it proposes to resell to El Paso from a number of producers (R. 122-123).

[3] A map of the El Paso System with these proposed additions appears at R. 335, the last page of the main volume of the Joint Appendix in the court below.

during the twenty-year term up to 26¢ (R. 142, 257).[4] It also contains the following provisions, which, in the view of the majority of the court below, excluded Commission jurisdiction (R. 149):

> All of the gas to be purchased by El Paso from Gatherer [Lo-Vaca] under this agreement shall be used by El Paso solely as fuel in El Paso's compressors, treating plants, boilers, camps and other facilities located outside of the State of Texas. It is understood, however, that said gas will be commingled with other gas being transported in El Paso's pipe line system.

In Article X, Section 2, the contract adds (R. 142):

> It is the intent and understanding of the parties hereto that the sale of natural gas hereof is not subject to the jurisdiction of the Federal Power Commission because this sale is not for resale. * * *[5]

This "restricted use" agreement provides for the separate metering of the contract volumes prior to their delivery into El Paso's system at Three Rivers. El Paso has stated that it will meter the gas used for fuel purposes in its New Mexico and Arizona facilities to make certain that this amount invariably exceeds the volumes of gas simultaneously taken from Lo-Vaca

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[4] The contract originally called for the delivery of an average of 50,000 Mcf of gas per day at Coquat. The amount was later increased to 80,000 Mcf per day (R. 257).

[5] Lo-Vaca has indicated, however, that it intends to sell gas under both contracts even if the Federal Power Commission has jurisdiction over the allegedly "restricted use" contract (R. 258).

under the "restricted use" contract (R. 260, 366).[6]

The Houston sale. By a contract dated July 19, 1960, Houston Pipe Line Company proposed to sell to El Paso, over a 20-year term, an average of 70,000 Mcf of gas per day, which it would purchase from various producers. The price to El Paso is to be determined under a formula which, in effect, adds 6⅛¢ per Mcf to Houston's average gas-purchase cost (R. 94-95). As in the case of Lo-Vaca, Houston's gas would be delivered to Gas Supply's pipeline at the Coquat Station. It, too, would be metered separately (R.59). The Houston contract contains a "restricted use" provision by which Houston purports to limit its gas to consumption within Texas (R. 78):

> * * * it is recognized that any gas purchased hereunder from Houston for such fuel consumption within Texas must necessarily be commingled with other gas being transported by El Paso in its pipe line system. In this connection, El Paso represents and convenants that the gas to be purchased by El Paso from Houston hereunder shall be used and consumed by El Paso solely as fuel in the operation of El Paso's plant and in the gasoline plant of Philips Petroleum Company in Ector County, all located wholly within the State of Texas. * * *

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[6] The metering of volumes of gas consumed in the compressor stations and other facilities of the pipeline is not peculiar to the present case; indeed, it is required by the Commission's Uniform System of Accounts in order to determine what portion of gas purchase costs should be attributed to the transmission-expense accounts. F.P.C. Uniform System of Accounts for Natural Gas Companies (Class A and Class B) Account 854, 18 C.F.R. Part 201, Account 854.

The contract provides further for the metering of the gas used at the various Texas points and includes a covenant by El Paso that the Texas uses will at all times exceed the amount simultaneously taken from Houston (R. 78-79). Houston's president acknowledged that his company's gas would actually be used outside of Texas (R. 53, 55, 56-57).

Soon after the execution of the contract, Houston petitioned the Commission for a declaratory ruling that the proposed sale would not be a sale in interstate commerce.[7] Since most of Houston's supply was purchased under contracts permitting the producers to cancel if their gas were to be resold in interstate commerce (R. 180-182), Houston alleged need for a prompt determination.

The facts of gas flow. The gas to be supplied by Lo-Vaca and Houston would be physically commingled after entry into Gas Supply's pipeline at the Coquat Station (R. 60). A small portion of this stream would be used as fuel in operating the Coquat compressor station, some would be used up by way of "line loss" in Gas Supply's pipeline from Coquat to Sonora, and some would be consumed at El Paso's Sonora dehydration plant (R. 61, 116, 117, 259). The rest would move, commingled with gas from the Sonora plant and other sources, through El Paso's mainline to Benedum Junction in Upton County, Texas, where the stream would divide (R. 61, 119, 259).

Thence one portion would flow toward El Paso's

[7] See F.P.C. Rules of Practice and Procedure, § 1.7 (c), 18 C.F.R. 1.7 (c).

Goldsmith Plant in Ector County, Texas, then northward to Plains, Texas (R. 259), and then westward, via El Paso's northern pipeline, through New Mexico and Arizona to the California border (*ibid*). Gas from numerous sources would enter the stream between Benedum Junction and Plains; at Plains itself, a stream from the Texas Panhandle would be added, and in New Mexico, San Juan Basin gas would enter the northern line (R. 62-65, 115, 259, 335).

The other portion of the stream would flow from Benedum Junction through Crane County, Texas, to El Paso's Keystone compressor station in Texas (R. 259).[8] From there, the main line of El Paso's southern pipeline extends into New Mexico, then back into Texas, again into New Mexico near the city of El Paso, and on to the border of California. In New Mexico, gas is added from various sources in that State and in Texas (R. 259). El Paso, however, had a pending application to construct a line from the Keystone Station to west Texas, and the Commission assumed the existence of that facility for purposes of this case. The building of this line would make it possible for El Paso to supply its west Texas compressor stations with gas produced and transported entirely in Texas. But, even then, the particular source or seller of the gas so used could not be determined since that gas would come from the

[8] This is the center of El Paso's Permian Basin facilities and one of its most important areas of gas supply. The flow diagram of the Permian Basin portion of the El Paso system which appears at R. 119 gives a fair impression of the great number and complexity of gas flows into the lines on this one portion of El Paso's system.

commingled stream leaving El Paso's Keystone Station (R. 259-260).[9]

Although both the El Paso-Lo-Vaca and El Paso-Houston contracts specify restricted uses for the gas sold under those contracts, it is conceded by respondents' officials that the gas sold by Houston and Lo-Vaca will flow in a commingled stream with gas from other sources and that at least a portion of the Houston and Lo-Vaca gas will in fact be used for resale in interstate commerce outside of Texas. See, *e.g.*, testimony of Houston's president (R. 56-57) and of El Paso's chief pipeline engineer (R. 66).[10]

The decision below. The Commission (one Commissioner dissenting as to the Houston sale) held that the sales by both Houston and Lo-Vaca would be sales for resale in interstate commerce and thus subject to its jurisdiction (R. 254-274). The court below (Judge Rives dissenting) set aside the Commission's determinations. Although it acknowledged that most of the gas sold under the restricted use contracts would in fact be resold in interstate commerce, the court concluded that gas is fungible and that separation into different uses could be determined by contract. The majority observed that while it "may well be that the

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[9] Since the time of the decision below, El Paso has withdrawn the application for these particular pipeline facilities. This withdrawal does not preclude El Paso from filing a new application to build comparable facilities.

[10] As a corollary to these admissions, it was conceded that the exhibits (R. 116, 117) introduced by respondents purporting to specify the particular facilities that would utilize Houston or Lo-Vaca gas were based entirely on the attribution to those uses made by the contracts with El Paso (R. 54-55, 360-361).

State of Texas has no incentive to regulate the cost" of the gas sold to El Paso under the "restricted use" contracts, the existence of such a regulatory gap has "no relevance in interpreting the statute." Judge Rives, dissenting, stated that in "no previous case has jurisdiction been permitted to turn upon the provisions of contracts not corresponding and not intended to correspond to reality" (R. 376).

ARGUMENT

THE HOUSTON AND LO-VACA SALES ARE SUBJECT TO FEDERAL REGULATION NOTWITHSTANDING THE RESTRICTED-USE PROVISIONS OF THE CONTRACTS, SINCE A SUBSTANTIAL PART OF THE GAS SUPPLIED THEREUNDER WILL IN FACT BE USED FOR RESALE IN INTERSTATE COMMERCE

Introduction and Summary

It is settled that where part of a stream of natural gas or electric energy sold under a single contract is interstate in character and is resold by the purchaser, the entire transaction falls within the Commission's jurisdiction, even though the remainder is consumed by the purchaser itself or within the producing State. *Pennsylvania Water & Power Co.* v. *Federal Power Commission*, 343 U.S. 414, 419-420; *United States* v. *Public Utilities Commission of California*, 345 U.S. 295, 316-318; *Federal Power Commission* v. *Southern California Edison Co.*, 376 U.S. 205, 209, n. 5. Here the parties concede that a substantial part of the gas sold under both the Houston and Lo-Vaca contracts will in fact travel out of Texas and be resold to purchasers

in other States (*supra*, p. 9). But for the contract language, therefore, both transactions would admittedly be subject to federal regulation. The question thus becomes: Is the jurisdictional status of a sale governed by what the purchaser actually does with the gas—*i.e.*, by the physical facts of gas flow—or is it controlled by the bare recitals of contract?

In our view, a contractual declaration of the type involved here cannot deprive the Commission of jurisdiction over a sale of gas to an interstate pipeline company where in fact the contract will not be performed in the manner recited. That declaration is not fulfilled merely by showing that the volume of gas used by the pipeline for the specified purpose (*e.g.*, compressor fuel) is equal to or greater than the volume covered by the contract; it must also be established that the gas used for that purpose was actually furnished by the supplier who seeks the exemption, and not by some other supplier. Here, the short of the matter is that only a small and indeterminate fraction of the gas sold by the two suppliers will be used for the purposes specified in the contracts.[11]

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[11] Different questions might arise if the restricted-use stipulation had been limited to that portion of the seller's gas which represented his *pro rata* contribution to the total volume of the restricted-use gas received by the pipeline from all sources (or, what is the same thing, a fraction of the seller's gas equal to that fraction of the pipeline's total intake which was used for the restricted purpose). That, however, is not the situation here. Lo-Vaca and Houston claim exemption not merely for a portion of their gas, but for all of it. The contracts arbitrarily attach a "restricted use" label to 100 percent of the volumes covered, despite the certainty that most of that gas will be resold outside of Texas. Thus, even if, contrary to our belief, it were permissible to compute the not-for-resale (or the

Federal regulation cannot be skirted by "a simple stroke of the draftsman's pen." Cf. *United States* v. *Township of Muskegon*, 355 U.S. 484, 486. The holding below—that the Commission's jurisdiction may be defeated by contractual declarations bearing no relationship to reality—is, we submit, without basis in the statute and contrary to the controlling decisions of this Court; by the same token, it invites serious gaps in the comprehensive regulatory scheme which Congress designed for the protection of consumers.

A. *The realities of gas flow, rather than artificial contractual stipulations, determine whether a sale is "in interstate commerce"*

We consider, first, the Houston contract, which purports to limit consumption of that seller's gas to points in Texas. While conceding that much of this gas will inevitably flow across State lines into New Mexico, Arizona, and California, Houston contends that, in light of its agreement with El Paso, the sale is not to be regarded as one in interstate commerce.[12] We disagree.

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intrastate) component of the seller's gas on the basis of a *pro rata* allocation, and feasible to do so, the contractual provisions here in issue would still be without jurisdictional significance.

[12] Respondents' claim (Br. in Op. 3) that their "restricted use" volumes would remain separately identifiable at all times is palpably without substance. The most that the metering of volumes for different purposes will accomplish is to assure that El Paso will at all times use sufficient quantities of gas for the restricted purposes called for by the Houston and Lo-Vaca contracts, so that it would not be impossible on a volume basis for the amounts delivered under that contract to be used for the restricted contract purposes. But this in no way alters the admitted fact that at least a substantial

Under both the Natural Gas and Federal Power Acts, this Court has consistently relied upon the physical facts in determining whether sales are in interstate commerce.[12] *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U.S. 61; *Interstate Natural Gas Co.* v. *Federal Power Commission*, 331 U.S. 682, 687; *Federal Power Commission* v. *East Ohio Gas Co.*, 338 U.S. 464, 467. As declared in *Connecticut Light & Power Co.* v. *Federal Power Commission*, 324 U.S. 515, 529, and reiterated last term in *Federal Power Commission* v. *Southern California Edison Co.*, 376 U.S. 205, 209 n. 5, federal jurisdiction follows the flow of the energy; the test under Part II of the Power Act is "engineering and scientific, rather than * * * legalistic or governmental." The same kind of test applies under the Natural Gas Act. The *Interstate* case, *supra*, in which the Court upheld the Commission's conclusion that the sales were in interstate commerce, illustrates its application (331 U.S. at 687):

> * * * The Federal Power Commission found that the gas sold to the three pipe-line companies moves "... in a constant flow from the mouths of the wells from which it is produced through pipe lines belonging to Interstate to the compressor station of the respective purchaser, and thence through said compressor stations into the pipe line of said respective purchaser and thus into and through

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portion of gas delivered by Houston for alleged use within Texas will in fact flow into other States for consumption there.

[12] Section 2 (7) of the Natural Gas Act defines "interstate commerce" as "commerce between any point in a State and any point outside thereof * * *."

> states other than Louisiana . . ., all without interruption, and said gas is so destined from the moment of its production." The Commission further found that "The gas transported and sold by Interstate to these three pipe line companies continues its flow in interstate commerce and, as an established course of business well known to Interstate, is destined for resale for ultimate public consumption in . . . markets outside Louisiana."

In short, the sale of gas which actually crosses a State border at any stage of its progress from well-head to ultimate consumption is "in interstate commerce." [14]

Since the actuality of transmission in commerce is the controlling consideration, this Court, in *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U.S. 61, 68-72, rejected a contention that federal jurisdiction depends on a specific intent to engage in interstate commerce. The Second Circuit's decision in *Hartford Electric Light Co.* v. *Federal Power Commission*, 131 F.2d 953, certiorari denied, 319 U.S. 741, bears upon the same point. There, the court considered

[14] Arguably, *Peoples Natural Gas Co.* v. *Public Service Commission of Pennsylvania*, 270 U.S. 550, a case long antedating the passage of the Natural Gas Act, might be taken to imply that a sale from a single stream of gas composed partly of gas from local wells and partly of out-of-State gas would be subject to State, rather than federal, jurisdiction where the portion of in-State gas in the mix exceeds the volume of the sale. To the extent that this is a permissible interpretation of the opinion, it is clear that the case has no continuing vitality in light of the specific holdings of this Court following the enactment of Part II of the Federal Power Act and of the Natural Gas Act. See, *e.g.*, the *Pennsylvania Water, Public Utilities Commission of California and Southern California Edison* cases cited in the text, *supra*.

in some detail the conditions under which a company which sold energy in the State of generation might nonetheless be engaged "in interstate commerce." It left open the possibility that a casual sale in the State of origin might not be "in interstate commerce," despite the subsequent interstate transportation of the energy by the purchaser, where the seller has no foreknowledge of that transportation. It concluded, however, that there could be no question of federal jurisdiction where the seller was "fully aware that some * * * energy is unavoidably destined by the buyer for interstate use." 131 F.2d at 960. Accord, *Deep South Oil Co.* v. *Federal Power Commission*, 247 F.2d 882 (C.A. 5).

In other, but related, contexts, this Court has also disregarded provisions of contracts which place a fictitious construction upon business transactions solely for the purpose of achieving a particular jurisdictional result. In *Sprout* v. *South Bend*, 277 U.S. 163, 168, the Court unanimously ruled that a motor bus line could not acquire the status of an exclusively interstate carrier simply by holding itself out as such and requiring each passenger to purchase a ticket to an out-of-state point, when in fact its passengers were regularly permitted to alight before reaching the State line. Similarly, in *Superior Oil Co.* v. *Mississippi*, 280 U.S. 390, the Court, upholding a State tax against the claim that the taxed sales were in interstate commerce, refused to give effect to a bill of lading which "seems to have had no other use than * * * to try to convert a domestic transaction into one of interstate com-

merce." 280 U.S. at 394. It "is 'not within the power of the parties by the form of their contract to convert what was exclusively a local business, subject to state control, into an interstate commerce business protected by the commerce clause'; * * * at least when the contract achieves nothing else." *Id.* at 394-395.

Even more closely in point is *B. & O. S.W.R.R. Co.* v. *Settle*, 260 U.S. 166, 170, which involved an elaborate contractual scheme designed to make one segment of an interstate transportation appear to be wholly intrastate. This was accomplished by interrupting the transit and delivering the goods to a "consignee" for several days before reshipping them to their ultimate destination. Looking to the shipper's actual business purpose—to get his goods to the ultimate point—the Court concluded that the entire transportation from beginning to end constituted interstate commerce, to which a higher interstate through rate was applicable.[15] Justice Brandeis' opinion for the Court declared (260 U.S. at 170): "* * * whether the interstate or the intrastate tariff is applicable depends upon the essential character of the movement. That the contract between the shipper and carrier does not necessarily determine the character was settled by a series of cases in which the subject received much consideration * * *."[16] See, also, *United States* v. *San Francisco*,

[15] In contrast are such cases as *Atlantic Coast Line R.R.* v. *Standard Oil Co.*, 275 U.S. 257, where the activities carried on within the State by the shipper after receipt of goods from interstate commerce have genuine business utility so that the goods may be fairly regarded as having come to rest; then any subsequent transportation within the State is a separate intrastate matter.

[16] In one of the cases there cited, the Court, in holding a transportation arrangement to be interstate, had explained that "[t]o

310 U.S. 16, 28; *Higgins* v. *Smith*, 308 U.S. 473, 477-478.

The "restricted use" provisions involved in the instant case are precisely the type of artifice which this Court has repeatedly condemned. Although the gas used to fuel El Paso's compressors (both in Texas and other States) comes from a variety of sources, El Paso has singled out particular suppliers for special treatment, arbitrarily labelling 100% of their contract volumes as "non-jurisdictional." These provisions could have no conceivable purpose or effect other than to circumvent regulation. Neither their removal from the Houston or Lo-Vaca contracts nor their insertion in the contracts of other suppliers would require the slightest change in El Paso's actual operations or in the routing of gas through its system.

B. *Similarly, the realities of gas flow determine whether a sale is "for resale"*

It is equally clear that the sale by Lo-Vaca is a sale "for resale," notwithstanding the contractual declaration that the gas shall be used by El Paso exclusively for fuel.[17] For it is undisputed that a substantial part of this "restricted use" gas will in fact be resold.

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hold otherwise would be to disregard * * * the substance of things and make evasions of the act of Congress quite easy." *Southern Pacific Terminal Co.* v. *Interstate Commerce Commission*, 219 U.S. 498, 526-527.

[17] As noted above (p. 5), the Lo-Vaca contract declares that the gas purchased thereunder is to be used in El Paso's facilities "outside of the State of Texas." Lo-Vaca's contention is that the sale, though in interstate commerce, is not a sale "for resale." See the Natural Gas Act, Section 1 (b), *supra*, p. 2.

The same emphasis upon concrete facts that has governed the question whether a transaction is "in interstate commerce" has also characterized this Court's approach to the question whether a sale is "for resale" and thus subject to the Commission's rate regulation. In *United States* v. *Public Utilities Commission of California*, 345 U.S. 295, a utility sold electric energy to the Navy Department, which used about 80% of it for its own consumption and resold the remainder to persons residing in a government housing project. This Court held that the entire transaction was subject to regulation by the Power Commission, stating (345 U.S. at 316):

> Certainly the concrete fact of resale of some portion of the electricity transmitted from a state to a point outside thereof invokes federal jurisdiction at the outset, despite the fact that the power thus used traveled along its interstate route "commingled" with the other power sold by the same seller and eventually directly consumed by the same purchaser-distributor * * *.[18]

The Court dismissed as "insubstantial" the company's contention that the contracts were not "for resale" because they did not state as much. 345 U.S. at 316. See, also, *California Electric Power Co.* v. *Federal Power Commission*, 199 F.2d 206 (C.A. 9), certiorari denied, 345 U.S. 934; *Deep South Oil Co.* v. *Federal Power Commission*, 247 F.2d 882 (C.A. 5). There is no reason

[18] We recognize that the Court left open the question whether federal jurisdiction would extend to "an essentially separate transaction covering the power directly consumed by the purchaser," *id.*, at 317-318. See discussion, *infra*, pp. 22-29.

why a contract such as Lo-Vaca's, which purports to preclude resale, albeit the parties know that an appreciable portion of the gas will in fact be resold, should have any greater significance for jurisdictional purposes than a contract, such as the one in the *California* case, which simply ignores the fact of resale altogether.[19]

Respondents maintain, however, that a contrary result is indicated by this Court's decision in *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1.[20] In that case, a New York utility

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[19] Despite the decision below, the Fifth Circuit in *Shell Oil Co.* v. *Federal Power Commission*, 247 F.2d 900, 902-903, certiorari denied, 355 U.S. 930, had earlier expressly rejected the argument that contractual language controls jurisdiction when at variance with the facts. There, one of the issues was whether Shell's contract was one "for resale" notwithstanding a contractual declaration that the gas was conveyed to the purchaser for the purpose of manufacturing gasoline. The court noted that the contract did not purport to forbid resale of the gas but indeed expressly accorded the purchaser the right to sell any surplus gas remaining after the extraction of the gasoline. But it went on to add (247 F.2d at 903):

> • • • But be this as it may, the legal determination of the question rests not upon the parties' use of the word "manufacture," but upon the actual disposition of the gas. The record here clearly shows that the gas sold to Phillips is resold by it and thus, as in Deep South, there can be no question that petitioner is making sales in interstate commerce of natural gas for resale within the meaning of the Act.

[20] Another "direct" sale case cited by respondent is *Houston Texas Gas & Oil Corp.*, 16 FPC 118, 17 FPC 303, affirmed *sub. nom. Florida Economic Advisory Council* v. *Federal Power Commission*, 251 F.2d 643 (C.A. D.C.), certiorari denied, 356 U.S. 959. There the court of appeals agreed with the Commission that there was no need to decide in that proceeding whether the "direct" sales in the field by Louisiana producers to a Florida power company were

(Consolidated Edison) purchased gas directly from the producers in Texas for use as boiler fuel and contracted with an interstate pipeline company (Transco) to have it transported to the place of consumption. It was assumed, both by the parties and by the Commission, that the sale was what it purported to be—a "direct" sale for Edison's own consumption— and that, as such, it was not subject to FPC regulation. However, in the exercise of its jurisdiction over the transportation of gas in interstate commerce, the Commission denied the pipeline a certificate on the ground, *inter alia*, that the purported end use of the gas as boiler fuel was an "inferior" use from the standpoint of conservation. This Court, after noting preliminarily and without discussion that the "direct" sale was non-jurisdictional (365 U.S. at 4), affirmed the denial of the transportation certificate. Respondents now point out that the gas allegedly sold to Edison would have been commingled in the pipeline with other gas owned by Transco, and that a substantial part of it would undoubtedly have been included in Transco's deliveries to its regular custom-

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jurisdictional (251 F.2d at 646-647; 16 FPC at 134; 17 FPC at 310). A finding that the sales were jurisdictional, it was urged, could result in cancellation of the "direct" sale contract and thus put in doubt the feasibility of the project. Since the Commission had required elimination of the contract cancellation clauses, the decision of the jurisdictional question was regarded as unnecessary. In *Houston*, which was decided several years before *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, the Commission, again with the court's concurrence, had held that it was unnecessary to decide initial price questions in a certificate proceeding since it had continuing rate jurisdiction.

ers. They argue that since the physical flow of the gas was not thought to give the Commission jurisdiction over the sale to Edison, it should likewise not confer jurisdiction over the sales here; the terms of the contract, they urge, should be controlling in the one case no less than in the other.

It may well be, as respondents suggest, that the reasoning which demands reversal of the decision below would similarly have justified the Commission in asserting jurisdiction over the so-called "direct" sale in *Transcontinental*. That was a question which the parties did not raise either before the Commission or in this Court, and which neither tribunal had need to consider in view of the Commission's refusal to authorize transportation of the gas.[21] The case is hardly a prece-

[21] The Commission's failure to notice the issue *sua sponte* may be due in part to two factors which give a different cast to a purported "direct" sale of boiler fuel gas to an industrial user or electric utility (such as Edison) as distinguished from a purported sale of compressor fuel gas to an interstate pipeline company (such as El Paso). 1) In the former case, unlike the latter, any excessive fuel cost incurred by the purchaser is not reflected in higher rates to the ultimate consumers of natural gas, whose protection was the principle purpose of the Act. In addition, the ready availability and relative simplicity of conversion to competing fuels is a powerful protection against the incurring of any excessive costs for such fuel gas by an electric utility (such as Edison) that would adversely affect its electric rates. 2) An industrial plant or electric utility, which purchases gas from only one, or at most a few, suppliers and uses it for its own consumption, has fewer opportunities to discriminate among suppliers or resale customers by means of contractual manipulations than does an interstate pipeline, which obtains gas from a multitude of sources and resells the bulk of it to numerous wholesale and retail customers, both interstate and intrastate.

dent for a point which was unnecessary to decision and never the subject of deliberation.[22]

C. *To permit limitation of the Commission's jurisdiction on the basis of artificial contractual stipulations would afford major opportunities for discrimination and create a class of independent producer sales which are free from effective regulation, State or federal*

We have argued above that the governing statutory language and the decisions of this Court compel the conclusion that the jurisdictional status of a sale depends upon the realities of gas flow, rather than upon contractual declarations which have no basis in fact and no conceivable purpose other than to escape regulation.

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[22] We suggest that a sound analysis of the transaction in *Transcontinental*, consistent both with the facts of gas flow and with the price arrangements formulated by the parties, would be as follows:

The producer has made a sale of gas to Edison in the field. Edison, in turn, has entered into an exchange agreement with Transco, under which (a) Edison delivers that gas to Transco in Texas; (b) Transco delivers an equivalent volume of gas to Edison's generating plant in New York; and (c) Edison pays Transco a fee for transporting the latter gas to New York. Since the gas purchased by Edison in the field was immediately resold (*i.e.*, exchanged for equivalent volumes) to Transco, the field sale is subject to the Commission's jurisdiction. The same is true of Edison's sale to Transco (or exchange with it), since the gas would be used by the pipeline for resale to its regular customers. The reciprocal sale by Transco to Edison of equivalent volumes in New York would be a sale for direct consumption and therefore non-jurisdictional. However, under its plenary power over "the transportation of natural gas in interstate commerce" (§§ 1 (b) and 7 (c) of the Act, 15 U.S.C. 717 (b), 717f (c))—the power successfully asserted in *Transcontinental*—the Commission would retain authority to certificate the pipeline's transportation service on such conditions as might be required by the public convenience and necessity.

We point additionally to certain of the consequences which would follow from a contrary holding.

(1) If a pipeline, in selling gas, were free to designate by contract the particular source (supplier or field) from which the gas should be deemed to come, albeit the gas in fact was an indistinguishable part of a stream emanating from many sources, the pipeline would be in a position to discriminate in favor of its "non-jurisdictional" customers (industrial users or intrastate distributors) by purportedly allocating to them its lower cost gas. Suppose, for example, that a pipeline was able to purchase gas in field X at a lower price than it had to pay producers in field Y, and that the gas from the two fields was commingled before delivery to customers. Suppose further that for competitive reasons the pipeline thought it advantageous to offer an industrial user a lower rate than it could profitably afford to charge its jurisdictional customers. Under the reasoning of the court below, the pipeline could reduce its rate to the industrial user without diminishing its overall revenues, simply by providing in its contract with the user that the gas supplied thereunder would be the cheaper gas from field X, while leaving its utility customers—and the ultimate consumers whose protection is the central object of the Natural Gas Act—to bear the higher cost of the gas purchased in field Y (or at least a disproportionate share of those costs).

(2) Another form of discrimination invited by the decision of the court of appeals is the preferential treatment of favored suppliers. This is clearly illus-

trated by the present case. If the decision below stands, El Paso, by a stroke of its pen, will have completely immunized from federal scrutiny the prices charged by two suppliers for gas which is no less destined for interstate markets than the gas of any other El Paso suppliers.

(3) Furthermore the decision below would create a class of sales by independent producers which are free from any effective rate regulation, State or federal. See *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1. For no State could be expected to regulate a sale to an interstate pipeline for ostensible use in the latter's own operations. The producing State (here, Texas), though perhaps having the power, would have little interest in regulating a item of pipeline cost which would be reflected chiefly in the rates paid by consumers in other States. And the consuming States that might have an interest (here, New Mexico, Arizona, and, particularly, California) would have no power to regulate sales of gas outside their own borders. The end result is a gap in the comprehensive regulation which Congress has established for the protection of consumers. As this Court noted in *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*, *supra*, 365 U.S. at 28:

> Congress did not desire an "attractive gap" in its regulatory scheme; rather, Congress intended to impose a comprehensive regulatory system on the transportation, production, and sale of this valuable natural resource. Therefore, when we are presented with an attempt by the federal authority to

> control a problem that is not, by its very nature, one with which state regulatory commissions can be expected to deal, the conclusion is irresistible that Congress desired regulation by federal authority rather than nonregulation. * * *

Petitioners answer (Br. in Op. 22) that the price paid by El Paso for the gas it obtains under these "nonjurisdictional" contracts will not be passed on to the ultimate consumers because the Commission, in regulating El Paso's resale rates, will attribute "the gas resold at the California border * * * to gas purchased by El Paso under jurisdictional sales; not Lo-Vaca and Houston restricted-use sales." This contention completely ignores the fact that a pipeline's cost of service includes not only the cost of purchased gas but all the costs incurred in delivering that gas, including the cost of compressor fuel. Thus, whether the gas purchased by El Paso from Lo-Vaca and Houston is deemed to be used "for resale" or for compressor fuel, the cost will in either case be reflected in the rates charged to the ultimate consumer. As this Court stated in *Interstate Natural Gas Co.* v. *Federal Power Commission*, 331 U.S. 682, 693:

> * * * Unreasonable charges exacted at this stage of the interstate movement become perpetuated in large part in fixed items of costs which must be covered by rates charged subsequent purchasers of the gas, including the ultimate consumer. It was to avoid such situations that the Natural Gas Act was passed.

To be sure, the Commission has power, in fixing a pipeline's rates, to disallow those items of cost which are shown to be plainly improvident. That power, however, is scarcely a substitute for the ability to pass upon producer prices at the time they are proposed. If it were, there would be no need for the Commission to regulate producer sales at all, for it could protect consumers simply by making appropriate adjustments in the pipeline's cost of service. But to say that a producer's proposed price is too high to warrant certification is not necessarily to say that the pipeline, once having paid that price, should later be denied the opportunity to recover its full costs (including a reasonable return)—especially where that denial might weaken the company's financial position and impair its ability to render efficient service.

Under the Fifth Circuit's decision, each interstate pipeline that uses a portion of the stream of gas to fuel its compressors and other auxiliary facilities (and that is almost every company) would be free to enter into as many non-jurisdictional contracts as it could fit within the volumetric limits of its use for these purposes. The Commission's "Statistics of Natural Gas Companies—1962" (the latest year available) show that the 40 major natural gas pipeline companies consumed more than $85,000,000 worth of gas in operating their utility facilities, principally compressor stations. This represents almost 4 percent of the total gas purchase costs of those companies.[23] Thus, without in any

[23] In El Paso's case, the cost of gas used to operate its utility plant is more than 7-¼ percent of its total gas purchase costs. *Ibid.*

way changing their actual operations, pipelines could create a substantial unregulated market for the benefit of particular producers merely by inserting into contracts of their choosing restrictive language similar to that employed in the Lo-Vaca and Houston contracts.[24]

D. *Cases in which the entire stream of gas is traceable to a single source are not controlling*

In holding the sales non-jurisdictional, the court below relied primarily upon a dictum of this Court in the *Public Utilities Commission of California* case, and upon the decisions of two courts of appeals, *City of Hastings, Nebraska* v. *Federal Power Commission*, 221 F.2d 31 (C.A. D.C.), certiorari denied, 349 U.S. 920, and *North Dakota* v. *Federal Power Commission*, 247 F.2d 173 (C.A. 8). We submit that the court's reliance upon those authorities was misplaced.

In the *California* case, as stated above (p. 18), this Court held that gas sold to a purchaser (the Navy) which consumed 80 percent of the energy but resold the balance was subject in its entirety to federal regulation. The Court also noted that it was leaving open the question whether the Commission's authority would extend to "an essentially separate transaction covering the power directly consumed by the purchaser" (345 U.S. at 317-318). The question thus reserved was later

[24] In addition to its direct impact on a purchaser's cost, the establishment of a sizable unregulated intrastate market could readily generate pressures to increase the general price level at which gas will be available for jurisdictional purposes, and also cause the triggering of favored-nations and other contract price-changing clauses. See *Federal Power Commission* v. *H. L. Hunt*, 376 U.S. 515, 524-525; *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 23-28.

answered in the negative by the courts of appeals in *Hastings* and *North Dakota*, both of which concurred in the Commission's disclaimer of jurisdiction over certain "essentially separate" transactions pertaining to gas either not resold by the purchaser or not in interstate commerce. As we show *infra*, it is quite unnecessary for present purposes to decide whether *Hastings* and *North Dakota* were correctly decided, *i.e.*, whether the Commission could properly have asserted jurisdiction over the transactions there in issue. This much at least is plain: the only rationale which might plausibly be thought to justify those decisions is wholly inapplicable to the present case and they therefore furnish no support whatever for the result reached below.

For the sake of clarity, we begin with this Court's comments in *California* as to the possible relevance of a "separate transaction"—comments which must be placed in context. There, the Navy received its entire supply of electric energy from a single source. Thus, a separate transaction such as the Court contemplated—one which pertained to the measurable amount of energy directly consumed by the Navy—would *ipso facto* have covered the precise amount of "not-for-resale" energy actually supplied by the particular seller whose rates were in issue. In other words, where "B" purchases *all* of its gas from "A" (which makes delivery through a single line of pipe) and "B" thereafter consumes 80 percent of the gas and resells the balance, one cannot say, to be sure, which molecules of "A" 's gas will be used by "B" and which resold; but one can say, with absolute assurance, that both the 80 percent and

the 20 percent constitute gas delivered by "A", rather than by some other supplier. The physical facts, viewed from "A" 's standpoint at the time of sale or delivery, would call for the conclusion that all of the gas put into the line is part of an indistinguishable stream subject in its entirety to the Commission's jurisdiction (see discussion, *supra,* p. 10); viewed from "B"'s standpoint at the time he allocates the gas to particular uses, however, it might be argued that the 80 percent actually consumed by "B" is both measurable in quantity and identifiable as to source, and that these physical facts are sufficient to justify a difference in regulatory treatment as between this gas and the remaining 20 percent.

The same can be said of the *City of Hastings* case, *supra*. There, the city received all its gas from an interstate pipeline at a number of city-gate delivery points, and used the supply partly for resale and partly as boiler fuel in its own electric generating plant; the volumes used at the plant were metered there after traveling through the city's system commingled with the volumes used for resale. The pipeline's federally-regulated rate schedule contained a provision making the rates inapplicable to "gas used or consumed by Utility * * * for industrial purposes." 221 F.2d at 34. Rejecting the city's contention that the pipeline's delivery at the city gate constituted a single sale subject in its entirety to FPC jurisdiction, the Commission found a long history of separate contracts and separate rates applicable to the gas used at the power plant; it concluded that the power plant gas was the subject of a separate sale for direct consumption and hence outside the Commission's

jurisdiction. We stress that in *Hastings*, as in *California*, it was possible to determine precisely how much of the gas supplied by that seller (Kansas-Nebraska) was resold by the buyer in interstate commerce and how much the buyer used for its own industrial purposes.[25]

By contrast, Lo-Vaca's gas would constitute but a small fraction of the total pouring into El Paso's system. Since it is not possible (as it was in *Hastings*) to trace the gas used at the compressor station to any particular seller, there is no realistic basis *from any standpoint* for the contractual assertion that the gas used for compressor fuel is that supplied by Lo-Vaca. Indeed, the compressor facilities are presently being fueled from a portion of the total stream supplied by numerous sellers, and the gas furnished by Lo-Vaca would merely become a minute and indistinguishable part of that stream.[26]

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[25] The contracts with Kansas-Nebraska did not, of course, purport to assign particular molecules to particular uses, or even to specify in advance what proportions of the Kansas-Nebraska gas would be used for resale and for boiler fuel, respectively. Since all the gas came from the same seller, it was feasible to make that determination after the event.

[26] Contrary to respondents' suggestion (Br. in Opp. 8, 27-28), the Commission's decisions in *Colorado Interstate Gas Co.*, 19 FPC 1012, 1022, and *City of Colton* v. *Southern California Edison Co.*, 26 FPC 223, set aside on other grounds *sub. nom. Southern California Edison Co.* v. *Federal Power Commission*, 310 F.2d 784 (C.A. 9), reversed, 376 U.S. 205, are fully consistent with its position here. *Colorado Interstate* followed the *Hastings* decision in a case where the pipeline had originally supplied gas for the purchaser's consumption as part of a single indivisible sale covering all of the purchaser's requirements, but where the parties later adopted a separate contract applicable to the sale for consumption. In *Colton*, as the decision shows (26 FPC at 226, 235), the delivery of energy

The *North Dakota* case, *supra,* bears the same relationship to the Houston sale as *Hastings* bears to the Lo-Vaca transaction. At issue there was the jurisdictional status of a sale in North Dakota by two producers (Signal and Amerada) to an interstate pipeline (Montana-Dakota) at an extraction plant which Signal operated at Tioga, North Dakota. From there the pipeline ran westward into Montana, serving four North Dakota towns by means of laterals branching off the line, and transporting in a single stream the gas which was to be diverted to the towns and that which was to continue across the border for resale in Montana. Significantly, the Tioga plant was the pipeline's only source of supply in the State; no other gas entered the pipeline between Tioga and the Montana border.[27] Although the pro-

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for the city's water pumping stations, which were held to be direct sales (and thus non-jurisdictional), were not only covered by separate schedules over which California was exercising jurisdiction, but in addition were made at points and over connecting lines separate and distinct from those used for the sales for resale to Colton. This aspect of the case was not at issue in the review proceedings.

Obviously, neither case, any more than *Hastings,* stands for respondents' proposition that the existence of a separate contract alone, absent the reality that the seller is actually supplying the gas which is used for the direct consumption, is sufficient to establish the non-jurisdictional status of a sale.

[27] Subsequent to the decision in *North Dakota,* these conditions have changed. Now the gas from the extraction plant at Tioga is commingled, prior to the so-called "intrastate" sales, with gas sold to Montana-Dakota by other producers from other sources. Nonetheless, only gas sold by Amerada and Signal at Tioga is contractually treated as gas sold in "intrastate" commerce. In view of the additional sources of supply, the Commission, following its opinion here, held that new firm gas sales by Amerada and Signal were sales for resale in interstate commerce. *Montana-Dakota Utilities Co.,* 30 FPC 200. That order was recently set aside by the

ducers executed separate contracts with Montana-Dakota, the Commission and the court of appeals appear to have treated the "intrastate" sales as a unit, presumably because the volumes supplied thereunder were delivered to the pipeline as a single stream of gas emanating from a single extraction plant and jointly owned by the two producers.[28] Thus, in *North Dakota*, as in *California* and *Hastings*, it was possible to identify with certainty the source of the gas actually used for the restricted non-jurisdictional purpose (intrastate resale), and also to determine how much of the total volume sold at Tioga was used by Montana-Dakota

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Eighth Circuit, which rejected the distinction proposed here and relied largely upon the reasoning of the decision below. *Amerada Petroleum Corporation, et al.* v. *FPC*, C.A. 8, Nos. 17445 and 17492, decided July 15, 1964. The Eighth Circuit's decision is essentially indistinguishable from the decision below, and the government contemplates the filing of a petition for certiorari in that case.

[28] The examiner, whose decision was adopted by the Commission, found that the "gas sold under the instant 16 cents contracts is admittedly produced and consumed wholly within the State of North Dakota * * *" (16 FPC at 408-409). This finding, which purports to describe the actual facts, is consistent only with treating the contracts as sales of jointly owned gas.

We note, however, that the Eighth Circuit in *Amerada Petroleum Corp., et al.* v. *Federal Power Commission*, C.A. 8, Nos. 17445 and 17492, decided July 15, 1964, disagrees with our view that the gas sold there was from a single source, stating (Slip Op. p. 12):

"* * * all of the gas sold under the former contracts which traveled in this branch of the pipeline did not originate from one source. Signal had no oil or gas fields of its own, but obtained its gas from other producers. Contrastingly, Amerada had its own areas of production. The Tioga plant represented a single distillation station of these combined sources of oil-well gas production, not a solitary source in the literal sense making physical identification of the intrastate gas any easier from the interstate gas. * * *"

for intrastate and how much for interstate resale.[29] In the case of Houston, this cannot be done.

It is also relevant to point out that the undesirable regulatory consequences (discussed *supra*, pp. 23-25) which would flow from the decision below were not similarly threatened in the *Hastings* and *North Dakota* situations. A pipeline which obtains all its gas from a single supplier is not ordinarily in a position to discriminate among its customers by arbitrary representations that the gas delivered to a particular customer has a particular origin. Nor (by definition) in the single-source situation would there be any opportunity for preferential treatment of favored suppliers, the vice conspicuously present in the instant case. Moreover, in the case of a sale to an interstate pipeline for resale

[29] It should be noted that the Commission in its recent decision in *Montana-Dakota Utilities Company*, 30 FPC 200 (see fn. 27, *supra*), indicated its belief that *North Dakota* was wrongly decided even on its own facts, since the decision "failed to take appropriate account of the fact that the gas as sold and delivered into MDU's pipeline by Amerada and Signal cannot be identified as gas for interstate use or gas for intrastate use, but constitutes a commingled and indistinguishable flow through an integrated interstate pipeline system in interstate commerce. * * *" The Commission has had no occasion to express its view as to the correctness of the *Hastings* decision. We note that in the *California* case this Court stated that the problem of whether a sale is "in interstate commerce" (the issue in *North Dakota*) is different from the problem of whether a sale is a "sale for resale" (the issue in *Hastings*); the Court implied that while separate rates, contracts, negotiations, or regulation might perhaps be enough to divide an admittedly interstate transaction into a sale for resale and a sale for consumption only, these elements might not suffice to divide a transaction into separate interstate and intrastate components (345 U.S. at 317). Accordingly, the Eighth Circuit's reliance upon *California* in *North Dakota* appears misplaced.

within the same State (as in *North Dakota*), the absence of federal jurisdiction would not inevitably permit the transaction to go entirely unregulated, since the State in question would have a strong interest in regulating the sale for the protection of its own resident consumers. (See *supra*, p. 24). To be sure, there remains the probability, even in the single-source situation, that a sale to a pipeline for its own system use will not be regulated by the State of sale—except, perhaps, where a substantial number of the ultimate consumers whose rates would be affected are residents of that State. (See, *supra*, p. 24). It should be noted, however, that in *Hastings* itself, the ultimate consumers *were* residents of Nebraska, the State of sale. In addition, since the restricted-use sale in *Hastings* was not to an interstate pipeline, but to a local utility for electric-generating purposes, there was no likelihood that the fuel price would be reflected in the rates of natural gas consumers (see, *supra*, p. 21, fn. 21). In sum, the practical considerations which add force to the legal argument for federal jurisdiction in the present case were very largely absent in *Hastings* and *North Dakota*.

If, notwithstanding these differences in factual circumstances and threatened consequences, it should be concluded that the logic of this Court's decisions concerning federal jurisdiction over commingled energy casts doubt upon the holdings in *Hastings* and *North Dakota*, the answer is not that which respondents would draw; that the decision below is a permissible one. The answer, rather, is that the force of this Court's decisions remains unimpaired and that the principles on which the decisions rest should be applied consistently.

CONCLUSION

The judgment of the court of appeals should be reversed with directions to affirm the Commission's order.

Respectfully submitted.

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